**BEFORE THE NEBRASKA TAX EQUALIZATION AND REVIEW COMMISSION**

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| THE VILLAGE AT PAPILLION, LP,<br><br>Appellant,<br><br>v.<br><br>SARPY COUNTY BOARD OF EQUALIZATION,<br><br>Appellee. | ) | Case No. 07C-085<br><br>DECISION AND ORDER AFFIRMING THE DECISION OF THE SARPY COUNTY BOARD OF EQUALIZATION |

The above-captioned case was called for a hearing on the merits of an appeal by The Village at Papillion, LP ("the Taxpayer") to the Tax Equalization and Review Commission ("the Commission"). The hearing was held in the Commission's Hearing Room on the sixth floor of the Nebraska State Office Building in the City of Lincoln, Lancaster County, Nebraska, on November 14, 2008, pursuant to an Order for Hearing and Notice of Hearing issued May 12, 2008. Commissioners Wickersham, Salmon, and Hotz were present. Commissioner Wickersham was the presiding hearing officer. Commissioner Warnes was excused from participation by the presiding hearing officer. The appeal was heard by a panel of three commissioners pursuant to 442 Neb. Admin. Code, ch. 4, §11 (10/07).

Melinda Golden, President of The Nicholas Group, the Managing Member of The Village at Papillion, LP, was present at the hearing with Trent R. Sidders as legal counsel.

Nicole L. O'Keefe, a Deputy County Attorney for Sarpy County, Nebraska, was present as legal counsel for the Sarpy County Board of Equalization (“the County Board”).

The Commission took statutory notice, received exhibits, and heard testimony.

The Commission is required to state its final decision and order concerning an appeal, with findings of fact and conclusions of law, on the record or in writing. Neb. Rev. Stat. §77-

5018 (Cum. Supp. 2006). The final decision and order of the Commission in this case is as follows.

## I.
## ISSUES

The Taxpayer has asserted that actual value of the subject property as of January 1, 2007, is less than actual value as determined by the County Board. The issues on appeal related to that assertion are:

Whether the decision of the County Board determining actual value of the subject property is unreasonable or arbitrary; and

The actual value of the subject property on January 1, 2007.

## II.
## FINDINGS OF FACT

The Commission finds and determines that:

1. The Taxpayer has a sufficient interest in the outcome of the above captioned appeal to maintain the appeal.
2. The parcel of real property to which this appeal pertains ("the Subject Property") is described in the table below.
3. Actual value of the subject property placed on the assessment roll as of January 1, 2007, ("the assessment date") by the Sarpy County Assessor, value as proposed in a timely protest, and actual value as determined by the County Board is shown in the following table:

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Description: Lot 10 Barrington Place 3, Papillion, Sarpy County, Nebraska.

| | Assessor Notice Value | Taxpayer Protest Value | Board Determined Value |
|---|---|---|---|
| Land | $319,055.00 | In Total | $319,055.00 |
| Improvement | $2,320,945.00 | In Total | $2,320,945.00 |
| Total | $2,640,000.00 | $1,470,783.00 | $2,640,000.00 |

4. An appeal of the County Board's decision was filed with the Commission.

5. The County Board was served with a Notice in Lieu of Summons and duly answered that Notice.

6. An Order for Hearing and Notice of Hearing issued on May 12, 2008, as amended by an Order issued on August 11, 2008, set a hearing of the appeal for November 14, 2008, at 11:00 a.m. CST.

7. An Affidavit of Service which appears in the records of the Commission establishes that a copy of the Order for Hearing and Notice of Hearing was served on all parties.

8. Actual value of the subject property as of the assessment date for the tax year 2007 is:

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| | |
|---|---|
| Land value | $ 319,055.00 |
| Improvement value | $2,320,945.00 |
| Total value | $2,640,000.00. |

## III.
## APPLICABLE LAW

1. Subject matter jurisdiction of the Commission in this appeal is over all questions necessary to determine taxable value. Neb. Rev. Stat. §77-5016(7) (Supp. 2007).

2. "Actual value is the most probable price expressed in terms of money that a property will bring if exposed for sale in the open market, or in an arm's length transaction, between a willing buyer and a willing seller, both of whom are knowledgeable concerning all the uses to which the real property is adapted and for which the real property is capable of being used. In analyzing the uses and restrictions applicable to real property the analysis shall include a full description of the physical characteristics of the real property and an identification of the property rights valued." Neb. Rev. Stat. §77-112 (Reissue 2003).

3. Actual value may be determined using professionally accepted mass appraisal methods, including, but not limited to, the (1) sales comparison approach using the guidelines in section 77-1371, (2) income approach, and (3) cost approach. Neb. Rev. Stat. §77-112 (Reissue 2003).

4. "Actual value, market value, and fair market value mean exactly the same thing." *Omaha Country Club v. Douglas County Board of Equalization, et al.*, 11 Neb.App. 171, 180, 645 N.W.2d 821, 829 ( 2002).

5. "(1)The county assessor shall perform an income-approach calculation for all rent-restricted housing projects constructed to allow an allocation of low-income housing tax credits under section 42 of the Internal Revenue Code and approved by the Nebraska Investment Finance Authority when considering the assessed valuation to place on the property for each assessment year. The income-approach calculation shall be consistent with any rules and regulations adopted and promulgated by the Property Tax Administrator and shall comply with professionally accepted mass appraisal techniques. Any low-income housing tax credits authorized under section 42 of the Internal Revenue

Code that were granted to owners of the project shall not be considered income for purposes of the calculation but may be considered in determining the capitalization rate to be used when capitalizing the income stream. The county assessor, in determining the actual value of any specific property, may consider other methods of determining value that are consistent with professionally accepted mass appraisal methods described in section 77-112.

(2) The owner of a rent-restricted housing project shall file a statement with the county assessor on or before October 1 of each year that details income and expense data for the prior year, a description of any land-use restrictions, and such other information as the county assessor may require." Neb. Rev. Stat. §77-1333 (Cum. supp. 2006)

6. Taxable value is the percentage of actual value subject to taxation as directed by section 77-201 of Nebraska Statutes and has the same meaning as assessed value. Neb. Rev. Stat. §77-131 (Reissue 2003).
7. All taxable real property, with the exception of agricultural land and horticultural land, shall be valued at actual value for purposes of taxation. Neb. Rev. Stat. §77-201(1) (Cum. Supp. 2006).
8. A presumption exists that the County Board has faithfully performed its duties and has acted on competent evidence. *City of York v. York County Bd. Of Equalization, 266 Neb.* 297, 64 N.W.2d 445 (2003).
9. The presumption in favor of the county board may be classified as a principle of procedure involving the burden of proof, namely, a taxpayer has the burden to prove that action by a board of equalization fixing or determining valuation of real estate for tax

purposes is unauthorized by or contrary to constitutional or statutory provisions governing taxation. *Gordman Properties Company v. Board of Equalization of Hall County*, 225 Neb. 169, 403 N.W.2d 366 (1987).

10. The presumption disappears if there is competent evidence to the contrary. Id.

11. The order, decision, determination, or action appealed from shall be affirmed unless evidence is adduced establishing that the order, decision, determination, or action was unreasonable or arbitrary. Neb. Rev. Stat. §77-5016 (8) (Cum. Supp. 2006).

12. Proof that the order, decision, determination, or action was unreasonable or arbitrary must be made by clear and convincing evidence. See, e.g. *Omaha Country Club v. Douglas Cty. Bd. of Equal.*, 11 Neb.App. 171, 645 N.W.2d 821 (2002).

13. "Clear and convincing evidence means and is that amount of evidence which produces in the trier of fact a firm belief or conviction about the existence of a fact to be proved." *Castellano v. Bitkower,* 216 Neb. 806, 812, 346 N.W.2d 249, 253 (1984).

14. A decision is "arbitrary" when it is made in disregard of the facts and circumstances and without some basis which could lead a reasonable person to the same conclusion. *Phelps Cty. Bd. of Equal. v. Graf*, 258 Neb 810, 606 N.W.2d 736 (2000).

15. A decision is unreasonable only if the evidence presented leaves no room for differences of opinion among reasonable minds. *Pittman v. Sarpy Cty. Bd. of Equal.,* 258 Neb 390, 603 N.W.2d 447 (1999).

16. A corporate officer or other representative of an entity, must be shown to be familiar with the property in question and have a knowledge of values generally in the vicinity to be

qualified to offer an opinion of value. *Kohl's Dept. Stores v. Douglas County Bd. of Equal.*, 10 Neb.App. 809, 638 N.W.2d, 881 (2002).

17. The County Board need not put on any evidence to support its valuation of the property at issue unless the taxpayer establishes the Board's valuation was unreasonable or arbitrary. *Bottorf v. Clay County Bd. of Equalization,* 7 Neb.App. 162, 580 N.W.2d 561 (1998).

18. A Taxpayer, who only produced evidence that was aimed at discrediting valuation methods utilized by the county assessor, failed to meet burden of proving that value of property was not fairly and proportionately equalized or that valuation placed upon property for tax purposes was unreasonable or arbitrary. *Beynon v. Board of Equalization of Lancaster County*, 213 Neb. 488, 329 N.W.2d 857 (1983).

19. A Taxpayer must introduce competent evidence of actual value of the subject property in order to successfully claim that the subject property is overvalued. Cf. *Lincoln Tel. and Tel. Co. v. County Bd. Of Equalization of York County,* 209 Neb. 465, 308 N.W.2d 515 (1981); *Arenson v. Cedar County*, 212 Neb. 62, 321 N.W.2d 427 (1982) (determination of equalized values); and *Josten-Wilbert Vault Co. v. Board of Equalization for Buffalo County*, 179 Neb. 415, 138 N.W.2d 641 (1965) (determination of actual value).

## IV.
## ANALYSIS

The subject property is an improved multifamily residential parcel. Improvements on the parcel are 6 apartment buildings containing 48 apartments. The apartments in the six apartment buildings are a mix of 2,3, and 4 bedroom units, all with 2 bathrooms. The parcel is also

improved with a clubhouse. The clubhouse contains a 3 bedroom apartment. The improvements were constructed in 2004.

The owner of the subject property has chosen to participate in a federally-sponsored program for the development of low-income housing. The program is authorized by Section 42 of the Internal Revenue Code of 1986 as the Federal Low-Income Housing Tax Credit Program. ("LIHTC"). LIHTC is administered by state agencies. The agency responsible for administration of the LIHTC in Nebraska is the Nebraska Investment Finance Authority ("NIFA"). 350 Neb. Admin. Code, ch. 51,§002.01)(A)(1) (05/07/05). There are benefits and burdens associated with LIHTC participation.

One benefit of LIHTC participation is a federal income tax credit. An LIHTC participant, if in compliance with various requirements, receives an annual credit to be used against federal income tax liability ("LIHTC credit") for a ten-year period. I.R.C. §42 (f)(1). LIHTC credits awarded to a project are based on the costs of the project development, the number of qualified low-income housing units included in the project, and other factors. See, *Valuation and Market Studies for Affordable Housing*, Richard E. Polton, Appraisal Institute, (2002) pp. 32 & 33. The annual amount of LIHTC credits available for award is limited on a state by state basis. I.R.C. §42 (h)(3). Credits are awarded to projects approved by NIFA. Because projects seeking approval would earn more credits than are available, awards of LIHTC credits by NIFA are made on a competitive basis.

The entity owning a project is usually a limited partnership or a limited liability company. See, *Valuation and Market Studies for Affordable Housing,* supra, p. 20. Once an agreement for reservation of credits or a final award of credits is made, an interest in the owner entity is sold to

an investor. See, *Valuation and Market Studies for Affordable Housing,* supra, p. 34. The sale is not the sale of an interest in real estate owned by the entity nor is it a sale of tax credits. The sale of an interest in the entity will, if expectations are met, allow the benefits of credits against income tax obligations to accrue to the buyer. The value paid for the purchased interest in the owner entity is determined by the investor based on the scheduled payment of the LIHTC credits over a ten year credit period and a desired rate of return. See, *Valuation and Market Studies for Affordable Housing,* supra, p. 75.

For example, total LIHTC credits to be made available over a ten year period might be $3,000,000.00. The value of those LIHTC credits to an investor is not $3,000,000.00 because they will be made available over time. Value is discounted at some rate to arrive at a present value for the delayed availability. The present value of the credit amount available in any year is simply that current amount which, with compounded interest, will equal the credit to be made available. See, *Valuation and Market Studies for Affordable Housing*, supra, pp 720-722. The discount rate will vary as the rates on investments vary. For example, if it is assumed that the LIHTC credits, as reserved, are made available in annual installments of $300,000 for ten years, the present value of those payments at a discount rate of 2% is $2,694,775.50.

Proceeds from the sale of an interest in the owner entity are used to fund development of the project. Proceeds from the sale may represent 50 to 60 percent of the cost of development. See, 350 Neb. Admin. Code, ch. 51 §004.04 (05/07/05). Other estimates are higher with proceeds being over 70% of the cost of development. See, *Valuation and Market Studies for Affordable Housing*, supra, p. 36.

The burdens associated with LIHTC participation are numerous. The burdens relate to tenant qualification, rents that may be charged, and management of the project. The owner of an LIHTC project must elect and qualify the project under either the "20-50" test or the "40-60 test." I.R.C. §42 (g)(1). Under the "20-50" test the project qualifies if 20% or more of the units are both rent-restricted and occupied by individuals whose income is 50% or less of the area median gross income. Under the "40-60" test, the project qualifies if 40% or more of the units are both rent-restricted and occupied by individuals with income of 60% or less of area median gross income.

No credit may be allowed unless there is an extended low-income housing commitment in effect. I.R.C. 42 (h)(6)(A). An extended low-income housing commitment is an agreement specifying the portion of each building that will be used for low-income housing, allowing enforcement of the rent qualifications in state courts, and allowing disposition only if the entire building is disposed of. I.R.C. 42 (h)(6)( B). The low-income housing agreement is recorded as a restrictive covenant against the real estate and is binding on the successors of the owner. I.R.C. 42 (h)(6)( B).

The maximum amount of rent that may be charged for a low-income unit in an LIHTC project is based on the gross median income adjusted for the assumed household size for a particular type of unit. See, *Valuation and Market Studies for Affordable Housing*, Richard E. Polton, Appraisal Institute, (2002) p. 39. The applicable gross median income is determined by an agency of the federal government. *Id*. The gross rents chargeable are then calculated with reference to the income limitations elected by the owner. *Id*. The maximum allowable rent is then reduced by a utility allowance. *Id*. The net allowable rent may be higher or lower than

market rents. See, *id.* at p. 41. When analyzing a low-income housing project three rents should be considered: Market rent, restricted rent, and actual or contract rents. Id. See also 350 Neb. Admin. Code, ch. 51 §004.06 (05/07/05).

Another burden of LIHTC participation is a requirement that the owner maintain the units of a LIHTC project so that they are suitable for occupancy, taking into account local health, safety, and building codes (or other habitability standards) or the uniform physical condition standards for public housing established by HUD. 26 CFR §1.42-5 (d)(2)(I) & (ii). The HUD physical standards do not preempt local health, safety, and building codes. 26 CFR §1.42-5 (d)(2)(ii). The creation and retention of various records is required. 26 CFR §1.42-5 (b). Reviews and inspections are another component of the compliance regime. 26 CFR §1.42-5 (b)(2).

Restrictions on rent and other conditions are imposed for an initial compliance period of 15 years. I.R.C. §42 (i)(1). Compliance with the restrictions is important because LIHTC credits are subject to recapture if compliance is not maintained. I.R.C. §42 (j). The restrictions on use may continue in effect during the period of an extended low-income housing commitment.

Sale of an LIHTC project subject to restrictions is not prohibited during the term of the low-income housing commitment. I.R.C. §42 (d)(7)(A). If an LIHTC project is sold, subject to restrictions, and credits are unused, then they are allocated between the parties. I.R.C. §42 (f)(4). If credits have been fully used then no allocation of credit is necessary. Special provisions govern a potential sale of a project for one year at the end of the compliance period. I.R.C. §42 (h)(6)(E) & (I). Interests in the entity owning an LIHTC project are freely transferable.

Nebraska law requires taxation of the subject property based on its actual value. Neb. Rev. Stat. §77-201(1) (Cum. Supp. 2006). "Actual value is the most probable price expressed in terms of money that a property will bring if exposed for sale in the open market, or in an arm's length transaction, between a willing buyer and a willing seller, both of whom are knowledgeable concerning all the uses to which the real property is adapted and for which the real property is capable of being used. In analyzing the uses and restrictions applicable to real property the analysis shall include a full description of the physical characteristics of the real property and an identification of the property rights valued." Neb. Rev. Stat. §77-112 (Reissue 2003). "Actual value, market value, and fair market value mean exactly the same thing." *Omaha Country Club v. Douglas County Board of Equalization, et al.*, 11 Neb.App. 171, 180, 645 N.W.2d 821, 829 (2002). Actual value may be determined using professionally accepted mass appraisal methods, including, but not limited to, the (1) sales comparison approach using the guidelines in section 77-1371, (2) income approach, and (3) cost approach. Neb. Rev. Stat. §77-112 (Reissue 2003).

Nebraska Statutes contain a specific provision concerning the valuation for taxation of rent-restricted housing projects qualifying for LIHTC credits. The statute in effect for assessment of the subject property was as follows:

> "(1) The county assessor shall perform an income-approach calculation for all rent-restricted housing projects constructed to allow an allocation of low-income housing tax credits under section 42 of the Internal Revenue Code and approved by the Nebraska Investment Finance Authority when considering the assessed valuation to place on the property for each assessment year. The income-approach calculation shall be consistent with any rules and regulations adopted and promulgated by the Property Tax

Administrator and shall comply with professionally accepted mass appraisal techniques. Any low-income housing tax credits authorized under section 42 of the Internal Revenue Code that were granted to owners of the project shall not be considered income for purposes of the calculation but may be considered in determining the capitalization rate to be used when capitalizing the income stream. The county assessor, in determining the actual value of any specific property, may consider other methods of determining value that are consistent with professionally accepted mass appraisal methods described in section 77-112.

(2) The owner of a rent-restricted housing project shall file a statement with the county assessor on or before October 1 of each year that details income and expense data for the prior year, a description of any land-use restrictions, and such other information as the county assessor may require." Neb. Rev. Stat. §77-1333 (Cum. Supp. 2006).

The Property Tax Administrator has promulgated rules and regulations as a guide to appraisers and assessors of the Department of Property Assessment and County Assessors and their appraisers in the appraisal of multi-family housing subject to income and/or rent restrictions imposed by federal/state/local programs (affordable housing). 350 Neb. Admin. Code ch. 51, §001.01 (05/07/05). Those rules were in effect for tax year 2006.

The rules and regulations of the Property Tax Administrator describe the interest to be appraised as "the fee simple interests in multi-family housing property. These rights include the real estate and all rights and privileges associated with the ownership therein. The value to be determined in the appraisal is the actual or market value of the property as set forth in Section 77-112 R.R.S. 2003." 350 Neb. Admin. Code ch. 51, §001.02 (05/07/05). "Value is created by

the anticipation of benefits to be derived in the future." *The Appraisal of Real Estate*, 12th Edition, Appraisal Institute (2001) p. 35.

A benefit derived from ownership of real estate with a LIHTC unit is the LIHTC credits. As discussed above, the value of the LIHTC credits is determined in a market composed of investors and entities with LIHTC eligible projects. Because payment of the credits is tied to a unit, a qualified sale of a building during the credit period allows the new owner to receive the unearned credits. I.R.C. §42 (f)(4). An owner selling a building would want to receive the value of that benefit and a buyer would be willing to pay for that benefit. For example, in the event of a foreclosure sale, the benefit of the LIHTC credits is considered a component of the value of the real estate being sold. See, *Valuation and Market Studies for Affordable Housing*, Richard E. Polton, Appraisal Institute, (2002) p. 101.

The question of whether the benefit derived from the tax credits should be considered when real estate is valued for purposes of ad valorem taxation has had a variety of answers in the Courts. Some Courts have held that LIHTC credits constitute an intangible, and are therefore not taxable as a part of the real estate. *Cottonwood Affordable Housing v. Yavapai County*, 205 Ariz. 427, 72 P.3d 357 (2003), *Maryville Properties L.P. v. Nelson,* 83 S.W.3d 608 (2002), and *Cascade Court Limited Partnership v. Noble*, 105 Wash.App. 563, 20 P.3d 997 (2001). Several Courts have expressly held that LIHTC credits are not intangible property. *Pine Point Housing, L.P. v. Lowndes County Bd of Tax Assessors*, 254 Ga.App. 197, 561 S.E.2d 860 (2002), *Town Square Limited Partnership v. Clay County Board of Equalization*, 704 N.W.2d 896 (2005), and *Rainbow Apartments v. Illinois Property Tax Appeal Bd.*, 326 Ill.App.3d 1105, 762 N.E.2d 534 (2001). Courts have held that the value of LIHTC credits must be included in a determination of

taxable value of real estate with a variety of rationales: *Parkside Townhomes Associates v. Board of Assessment Appeals of York County*, 711 A.2d 607 (1998), (Effect of tax credits part of economic reality and must be considered); *In re Ottawa Housing Assoc., L.P.* 27 Kan. App.2d 1008, 10 P.3d 777 (2000), (Fair market value is affected by investment tools. Low income housing contracts are investment tools and have to be considered); *Hometowne Associates, L.P. v. Maley*, 839 N.E.2d 269 (2005), (Tax credits are considered in a calculation of an obsolescence adjustment); *Huron Ridge LP v. Ypsilanti Township*, 275 Mich.App. 23, 737 N.W.2d 187 (2007), (Fair market value of IRC §42 housing is not merely influenced by, but primarily driven by tax credits. Value of property would be artificially depressed if the value of tax credits is not included); *Brandon Bay Limited Partnership v. Payette County*, 142 Idaho 681, 132 P.3d 438 (2006), (Tax credits were rights and privileges belonging to real estate and properly considered in valuation of property); *Spring Hill, L.P. v. Tennessee State Board of Equalization*, 2003 WL 23099679 (Tenn.Ct.App), (See Tennessee Court of Appeals Rules 11 and 12), (Consideration of the value-decreasing factor of restricted rents along with the value increasing factor of Tax Credits provides a full and accurate picture of the property's worth); *Pine Pointe Housing, L.P. v. Lowndes County Board of Tax Assessors*, 254 Ga.App. 197, 561 S.E.2d 860 (2002) (Tax credits go hand in hand with restrictive covenants that require the property to charge below-market rent. If viewed in isolation the rental restrictions would artificially depress the value of the property for tax valuation purposes.); *Pedcor Investments v. State Board of Tax Commissioners*, 715 N.E.2d 432 (1999), (Tax credits create economic benefit and cannot be ignored in a determination of economic obsolescence).

The definition of real property found in Nebraska Statutes includes "all privileges." Neb. Rev. Stat. §77-103 (Reissue 2003). Privileges pertaining to real property have been defined by the Property Tax Administrator as the right to sell, lease, use, give away, or enter, and the right to refuse to do any of these. 350 Neb. Admin Code, ch. 10 §001.01F (05/05). A long-term lease, for example, is considered a privilege in Nebraska. See, *Omaha Country Club v. Douglas County Board of Equalization,* 11 Neb.App. 171, 645 N.W.2d 821 (2002). In *Omaha Country Club,* the Court determined that "the actual or fair market value of the real property can only be ascertained by first determining the fee simple value, including the value of the leasehold estate, the leased fee estate, and any other severed estate." Id, at 182, 831. The Court went on to find that "the actual value of real property for tax purposes shall be the value a willing buyer would be willing to pay for the fee simple interest." Id. LIHTC credits are transferable and a part of the economic reality of parcels subject to the agreements which make their use possible. *Town Square Limited Partnership v. Clay County Board of Equalization*, 704 N.W.2d 896 (2005). The rationale described by the *Town Square* Court for inclusion of value of LIHTC credits in the valuation of real property is persuasive and consistent with Nebraska law.

Section 77-1333 of Nebraska Statutes requires exclusion of LIHTC credits from income if the income approach is used to develop an estimate of actual value. The statute clearly prohibits addition of the annual credit amount to the rents and other income of a parcel. The Statute does not, however, prohibit consideration of the value that might be attributable to the LIHTC credits in any other context or other valuation approaches. Section 77-1333 recognizes, for example, that the existence of LIHTC credits could be a factor in the development of a capitalization rate. Determining the contribution to value represented by the benefit of the

LIHTC credits does not violate the terms of the statute. The rationale described by the *Town Square* Court for inclusion of value of LIHTC credits in the valuation of real property is persuasive and consistent with Nebraska law.

Another benefit derived from ownership of an LIHTC project is current income. Value may be attributed to the current income benefit. The value of the benefit to be derived from current income can be determined by capitalizing income. "The income capitalization approach to value consists of methods, techniques, and mathematical procedures that an appraiser uses to analyze a property's capacity to generate benefits (i.e., usually the monetary benefits of income and reversion ) and convert these benefits into an indication of present value." *The Appraisal of Real Estate*, 12th Edition, Appraisal Institute (2001) p. 471.

The Income Approach can be defined as "a set of procedures through which an appraiser derives a value indication for an income-producing property by converting its anticipated benefits (cash flows and reversion) into property value. This conversion can be accomplished in two ways. One year's income expectancy can be capitalized at a market-derived rate or at a capitalization rate that reflects a specified income pattern, return on investment, and change in the value of the investment. Alternatively, the annual cash flows for the holding period and the reversion can be discounted at a specified yield rate." *The Dictionary of Real Estate Appraisal*, Fourth Edition, Appraisal Institute, p.143, (2002). The steps required for use of the income approach with direct capitalization may be summarized as (1) estimate potential gross income; (2) deduct estimated vacancy and collection loss to determine effective gross income; (3) deduct estimated expenses to determine net operating income; (4) divide net operating income by an estimated capitalization rate to yield indicated value. *The Appraisal of Real Estate* 12th Edition,

The Appraisal Institute, (2001), pp. 493 - 494. A variety of techniques may be used to quantify various components of any application of the approach. *The Appraisal of Real Estate*, supra, chs 20-24, (2001).

The Property Tax Administrator in rules and regulations gave the following guidance for use of the income approach in the valuation of affordable housing. "The appropriate income approach for use in appraisal is to determine the potential gross income attributable to the property using economic or typical rent for the type of property in the county, community, or neighborhood. Allowances for vacancies and collections relative to the type of property being appraised are deducted from the estimate of potential gross income. Typically, allowable expenses are deducted from the estimate of potential gross income to give an indication of the net operating income attributable to ownership of the property. Expenses peculiar to affordable housing should not be over-looked. In many cases, owners of such housing are required to keep detailed records in order to meet state and federal compliance reporting requirements. To the net income from the rental of the property is added net income from other operations. Typically the 'other net income' includes income from laundry, vending machines, and rental of garages. This net operating income is capitalized or divided by a rate which reflects the returns to ownership of the type of property common to the area." 350 Neb. Admin. Code, ch. 51, §005.04A (05/07/05).

The restrictions imposed by participation in the LIHTC program may mean lower effective gross income and higher costs than those which would be expected in the operation of an unrestricted property. Recognition of the impact of restrictions does not however require use of actual operating results of a project in the income approach. See, *Valuation and Market Studies for Affordable Housing*, Richard E. Polton, Appraisal Institute, (2002) pp. 94-97.

Reliance on actual income or expenses of the subject property is not in accordance with generally accepted appraisal practice. "The income and expenses that are proper and acceptable for income tax purposes are not the same as those that are appropriate for the income approach. Only the reasonable and typical expenses necessary to support and maintain the income-producing capacity of the property should be allowed." *Property Assessment Valuation*, 2nd Ed., International Association of Assessing Officers, (1996), p. 204. That position has also been adopted by Nebraska Courts. See, *In re Assessment of OL & B Ry. Co.,* 213 Neb. 71, 75-76, 327 N.W.2d 108, 111 (1982) and *Spencer Holiday House, Inc., v. Board of Equalization of Hall County,* 220 Neb. 607, 371 N.W.2d 286 (1985). The owner of a rent-restricted housing project is required to file a statement with the county assessor on or before October 1 of each year that details income and expense data for the prior year. Neb. Rev. Stat. §77-1333 (Sum. Supp. 2006). If provided, the data would be a basis for developing estimates of income and expenses for rent-restricted housing projects.

A capitalization rate must be developed for use in the income approach. A capitalization rate may be determined based on analysis of sales of comparable properties, effective gross income multipliers and net income ratios, and consideration of mortgage and equity components in the band of investment technique. *The Appraisal of Real Estate*, 12th Edition, Appraisal Institute (2001) p. 35. Section 77-1333 of Nebraska Statutes specifically provides for consideration of LIHTC credits as a component of a capitalization rate used for development of an estimate of actual value based on the income approach. Other factors such as market area characteristics, overall risk levels, quality and durability of income, expenses, site and area characteristics, physical characteristics locational characteristics and program structure may be

considered to reduce or lessen risk and therefore reduce or increase the appropriate capitalization rate. *Valuation and Market Studies for Affordable Housing*, Richard E. Polton, Appraisal Institute, (2002) p. 105.

The portion of the rules and regulations of the Property Tax Administrator providing guidance for tax year 2006 to appraisers and assessors of the Department of Property Assessment and Taxation and County Assessors and their appraisers for development of a capitalization rate when using the income approach for the valuation of affordable housing parcels is set out in full:

> "005.04E The income capitalization method should not be applied in a manner that unfairly ignores the market for similar properties in the area. Rental rates, productivity, and restrictions imposed upon the use of the real property must be considered to determine actual value.
> 005.04E(1) The capitalization rate is the theoretical risk rate of interest applied by valuators in calculating the present value of future returns. The capitalization rate for affordable housing may be developed from time to time through the band-of-investment technique.
> 005.04E(2) The band-of-investment technique may be used to develop a composite rate from the market.
> 005.04E(3) From the market composite rate the equity yield rate for the equity investor may be estimated recognizing the ratio of loan to value for the subject property.
> 005.04E(4) This method has the advantages of;
> 005.04e(4)a. The composite rate will always be the same regardless of the mortgage and equity ratios;
> 005.04E(4)b. Any mortgage position should always be superior to that of the equity rate because it is fixed by contract and burden of management is the responsibility of the equity owner; and,
> 005.04E(4)c. The risk of equity investment increases as its ratio to value declines thus prospective yield should increase accordingly.
> 005.04F One of the following methods may be selected to estimate an income approach valuation for the property.
> 005.04F(1) Direct capitalization of net operating income utilizing a capitalization rate developed in consideration of the value of any low-income housing tax credits relating to the property;
> 005.04F(2) Capitalization by a modified band of investment technique." 350 Neb. Admin. Code, ch. 51, §005.04E (05/07/05).

The band of investment technique for determining a capitalization rate is a generally recognized appraisal methodology. *The Appraisal of Real Estate*, supra, p. 534. The band of investment method is defined as “a technique in which the capitalization rates attributable to components of a capital investment are weighted and combined to derive a weighted-average rate attributable to the total investment.” *The Appraisal of Real Estate*, supra, p. 535. The components of the formula for derivation of a capitalization rate using the band of investment techniques and their definitions follow.

“Mortgage capitalization rate ($R_M$): The capitalization rate for debt; the ratio of the annual debt service to the principal amount of the mortgage loan. A mortgage capitalization rate may be calculated based on the initial mortgage amount or the outstanding mortgage amount. Also known as *annual constant*. ($R_M$=debt service/mortgage principal).

Equity capitalization rate ($R_E$): An income rate that reflects the relationship between a single year’s equity dividend and the initial equity investment; used to convert equity dividend into an equity value indication; also called the *cash on cash rate, cash flow rate*, or *equity dividend rate*. ($R_E$=equity dividend/equity invested).

Equity yield rate ($Y_E$): A rate of return on equity capital as distinguished from the rate of return on debt capital (the interest rate); the equity investor’s internal rate of return. The equity yield rate considers the effect of debt financing on the cash flow to the equity investor.

Loan-to-value ratio (M): the ratio between a mortgage loan and the value of the property pledged as security, usually expressed as a percentage.

Equity ratio (E): The ratio between the equity investment on a property and its total price; the fraction of the investment that is unencumbered by debt." *The Appraisal of Real Estate*, supra, p. 535.

"Equity dividend ($I_E$) is the portion of net operating income that remains after debt service is paid." *The Appraisal of Real Estate*, supra, p. 484.

The formula for calculation of the capitalization rate using the band of investment technique is $(M \times R_M) + (E \times R_E) = Rate$.

A market rate project may have a loan-to-value ratio of 75% and an equity ratio of 25%. *Valuation and Market Studies for Affordable Housing*, supra, p. 35. An affordable housing project may have a loan to value ratio of 25% and an equity ratio of 75%. Id. Capitalization rates developed based on a constant mortgage capitalization rate and a constant equity yield rate show the divergent results from application of the band of investment rate formula for market as opposed to affordable housing projects.

Market

$(.75\ M \times .08\ R_M) + (.25\ E \times .06\ Y_E) = .075$

Affordable Housing

$(.25\ M \times .08\ R_M) + (.75\ E \times .06\ Y_E) = .065$.

The effect of the lower capitalization rate applied to a given net operating income would be a higher estimate of value. Section 77-1333 of Nebraska Statutes states that the benefit of the LIHTC credits may be recognized in the development of a capitalization rate. The band of investment technique as illustrated does that by recognizing the low loan-to-value ratio after receipt of the proceeds from the transfer of an interest in the owner entity passing through the tax

credits to an investor. If there is no equity dividend expected from current income of an affordable housing project or if it does not have equity the results from application of the band of investment formula would show a greater divergence between the derived capitalizations rates for market projects and affordable housing projects.

Use of real estate in an LIHTC project is not restricted in perpetuity. The benefits of owning income-producing real estate include proceeds from the disposition of the property at termination of the investment. *The Appraisal of Real Estate*, supra, p.483. The minimum restriction period is 15 years. I.R.C. §42 (i)(1). A longer period may be agreed to. At the end of the restriction period the property reverts to an unrestricted use with a potentially higher current earning capacity. A potentially higher earning capacity would support a higher value. Anticipation of that higher value, based on a reversion to an unrestricted status, is a benefit and may be valued. "Reversionary benefits are usually estimated as anticipated dollar amounts or as relative changes in value over the presumed holding period." *The Appraisal of Real Estate*, supra, p. 485. The value of the reversionary benefit can be calculated as the difference between the value of the current income benefit as restricted, and the value of the current income benefit if unrestricted, capitalized at an appropriate rate until termination of the restrictions. See, *The Appraisal of Real Estate*, supra, at p. 91. One commentator suggests that the reversion value should only be calculated at or near the end of the restriction's term. See, *Valuation and Market Studies for Affordable Housing*, Richard E. Polton, Appraisal Institute (2002) p. 91. It is apparent, however, that a value existed for the reversionary benefit from the commencement of the restriction's term. While the value of that benefit may become greater near the end of the term, it has value throughout the term and should be recognized. The Supreme Court of the

State of Washington expressly held on analogous facts, property subject to a long term lease, that if market rent exceeds contract rent the leasehold bonus (the difference between market rents and contract rents) should be capitalized and the value of the property should be determined by adding the present value of the leasehold bonus to capitalized value of the contract rent. See, *Folsom v. County of Spokane*, 111 Wash.2d 256, 759 P.2d 1196 (1988). Here, "contract income," as affected by the agreement between the owner and NIFA, may be less than "market income." The principle described in *Folsom* seems clearly applicable.

Estimates of value based on use of the income approach with restricted rents and expenses unique to LIHTC projects are incomplete without consideration of the contribution to actual value of LIHTC credits and the reversionary interest and may understate actual value. The Commission finds that actual value of an LIHTC project may be determined as the sum of the contributions to value of the LIHTC credit benefit, the current income benefit, and the reversionary benefit. In addition to use of the income approach for determinations of actual value, actual value of an LIHTC project may be determined by use of the cost approach or the sales comparison approach. Neb. Rev. Stat. 77-1333 (Cum. Supp. 2006).

An appraiser for the Taxpayer ("Appraiser") testified that in his opinion market value of the subject property as of January 1, 2007, was $1,735,000.00. The opinion of the Appraiser was supported by an appraisal report received as Exhibit 3. The interest valued by the Appraiser was the leased fee interest. (E3:5). The cost approach and the direct sales comparison approach were deemed inapplicable by the Appraiser. (E3:7). The opinion of value given by the Appraiser was based on an estimate of value derived from use of the income capitalization approach. (E3:7). Tax credits, in the amount of $325,000 per year were awarded to the subject property in 2005.

E2:2). The credits, if paid in full over ten years, will total \$3,250,000.00. Eight years of credits were still payable as of January 1, 2007. The total amount of those credits was \$2,600,000.00. The contribution to value of tax credits was not considered in the market value estimate of the Appraiser. (E3:5).

The County Board's determination of actual value is based on an application of the income approach. (E6:3). The capitalization rate developed for use by the County Board was based on the band on investment method. (E10:1). The subject property was acquired and constructed at a total cost of \$4,893,974. (E2:2). On completion, the subject property became encumbered with a permanent loan of \$2,138,819. (E3:68). The loan to value ratio can be calculated as 43.70% (\$2,138,819 ÷ \$4,893,974 = .4370). Using the assumed mortgage interest rate, equity dividend rate, and mortgage constant utilized by the County Board the capitalization rate indicated by the band of investment method is calculated as follows:

| | |
|---|---|
| Loan to Value Ratio | 43.70% |
| Equity | 55.38% |
| Mortgage Interest Rate | 6.00% |
| Mortgage Constant | 7.19% |
| Equity Dividend Rate 6.00% | |
| Cap Rate (.4370 x .0719) + (.5538 x .06) = .0646 or | 6.46% |

The capitalization rate derived without modification to recognize the loan to value ratio of the subject property was 6.833 %. (E10:2). When modified as suggested in the rules and regulations promulgated by the Property Tax Administrator the band of investment technique recognizes the effect of the tax credits, lowering the debt ratio. Lowering the debt ratio affects

the indicated capitalization rate as shown. Recognition of the contribution to value of tax credits through an adjustment to the capitalization rate is specifically recognized as a valuation technique by statute. Neb. Rev. Stat. §77-1333 (Cum. Supp. 2007). The band of investment technique as developed for use by the County Board did not recognize the application of the band of investment techniques as described in Exhibit 10 at page 2, and did not recognize the contribution to actual value of the tax credits as a component of the capitalization rate. At any given net income a higher capitalization rate produces a lower indicated value. Since the capitalization rate developed for use by the County Board is higher than the rate developed after modification of the loan to value ratio, the County Board's determination of actual value is lower than indicated by the analysis above.

The County Board's determination of actual value was not unreasonable or arbitrary.

## V.
## CONCLUSIONS OF LAW

1. The Commission has subject matter jurisdiction in this appeal.
2. The Commission has jurisdiction over the parties to this appeal.
3. The Taxpayer has not produced competent evidence that the County Board failed to faithfully perform its official duties and to act on sufficient competent evidence to justify its actions.
4. The Taxpayer has not adduced sufficient, clear and convincing evidence that the decision of the County Board is unreasonable or arbitrary and the decision of the County Board should be affirmed.

## VI.
## ORDER

**IT IS ORDERED THAT:**

1. The decision of the County Board determining actual value of the subject property as of the assessment date, January 1, 2007, is affirmed.
2. Actual value, for the tax year 2007, of the subject property is:

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| | |
|---|---|
| Land value | $ 319,055.00 |
| Improvement value | $2,320,945.00 |
| Total value | $2,640,000.00. |

3. This decision, if no appeal is timely filed, shall be certified to the Sarpy County Treasurer, and the Sarpy County Assessor, pursuant to Neb. Rev. Stat. §77-5018 (Cum. Supp. 2006).
4. Any request for relief, by any party, which is not specifically provided for by this order is denied.
5. Each party is to bear its own costs in this proceeding.
6. This decision shall only be applicable to tax year 2007.
7. This order is effective for purposes of appeal on June 2, 2009.

Signed and Sealed. June 2, 2009.

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Nancy J. Salmon, Commissioner

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Robert W. Hotz, Commissioner

**SEAL**

**APPEALS FROM DECISIONS OF THE COMMISSION MUST SATISFY THE REQUIREMENTS OF NEB. REV. STAT. §77-5019 (CUM. SUPP. 2006), OTHER PROVISIONS OF NEBRASKA STATUTES, AND COURT RULES.**

I concur in the result.

I do not believe consideration of two standards of review is required by statute or case law.

The Commission is an administrative agency of state government. See, *Creighton St. Joseph Regional Hospital v. Nebraska Tax Equalization and Review Commission*, 260 Neb. 905, 620 N.W.2d 90 (2000). As an administrative agency of state government the Commission has only the powers and authority granted to it by statute. Id. The Commission is authorized by statute to review appeals from decisions of a county board of equalization, the Tax Commissioner, and the Department of Motor Vehicles. Neb. Rev. Stat. §77-5007 (Supp. 2007). In general the Commission may only grant relief on appeal if it is shown that the order, decision, determination, or action appealed from was unreasonable or arbitrary. Neb. Rev. Stat. §77-5016(8) (Cum. Supp. 2008).

The Commission is authorized to review decision of a County Board of Equalization determining taxable values. Neb. Rev. Stat. §77-5007 (Supp. 2007). Review of County Board of Equalization decisions is not new in Nebraska law. As early as 1903 Nebraska Statutes provided for review of County Board assessment decisions by the district courts. Laws 1903, c. 73 §124. The statute providing for review did not state a standard for that review. Id. A standard of review stated as a presumption was adopted by Nebraska's Supreme Court. See, *State v. Savage*, 65 Neb. 714, 91 N.W. 716 (1902) (citing *Dixon Co. v. Halstead*, 23 Neb. 697, 37 N.W. 621 (1888) and *State v. County Board of Dodge Co.* 20 Neb. 595, 31 N.W. 117 (1887). The

presumption was that the County Board had faithfully performed its official duties and had acted upon sufficient competent evidence to justify its actions. See, Id. In 1959 the legislature provided a statutory standard for review by the district courts of county board of equalization, assessment decisions. 1959 Neb Laws, LB 55, §3. The statutory standard of review required the District Court to affirm the decision of the county board of equalization unless the decision was arbitrary or unreasonable or the value as established was too low. Id. The statutory standard of review was codified in section 77-1511 of the Nebraska Statutes. Neb. Rev. Stat. §77-1511 (Cum. Supp. 1959). After adoption of the statutory standard of review Nebraska Courts have held that the provisions of section 77-5011 of the Nebraska Statutes created a presumption that the County Board has faithfully performed its official duties and has acted upon sufficient competent evidence to justify its actions. See, e.g. *Ideal Basic Indus. V. Nucholls Cty. Bd. Of Equal*., 231 Neb. 297, 437 N.W.2d 501 (1989). The presumption stated by the Court was the presumption that had been found before the statute was enacted.

Many appeals of decisions made pursuant to section 77-1511 were decided without reference to the statutory standard of review applicable to the district courts review of a county board of equalization's decision. See, e.g. *Grainger Brothers Company v. County Board of Equalization of the County of Lancaster*, 180 Neb. 571, 144 N.W.2d 161 (1966). In *Hastings Building Co., v. Board of Equalization of Adams County*, 190 Neb. 63, 206 N.W.2d 338 (1973), the Nebraska Supreme Court acknowledged that two standards of review existed for reviews by the district court; one statutory requiring a finding that the decision reviewed was unreasonable or arbitrary, and another judicial requiring a finding that a presumption that the county board of equalization faithfully performed its official duties and acted upon sufficient competent evidence

was overcome. No attempt was made by the *Hastings* Court to reconcile the two standards of review that were applicable to the District Courts.

The Tax Equalization and Review Commission was created in 1995. 1995 Neb. Laws, LB 490 §153. Section 77-1511 of the Nebraska Statutes was made applicable to review of county board of equalization assessment decisions by the Commission. Id. In 2001 section 77-1511 of Nebraska Statutes was repealed. 2001 Neb. Laws, LB 465, §12. After repeal of section 77-1511 the standard for review to be applied by the Commission in most appeals was stated in section 77-5016 of the Nebraska Statutes. Section 77-5016(8) requires a finding that the decision being reviewed was unreasonable or arbitrary. *Brenner v. Banner County Board of Equalization*, 276 Neb. 275, 753 N.W.2d 802 (2008). The Supreme Court has stated that the presumption which arose from section 77-1511 is applicable to the decisions of the Commission. *Garvey Elevators, Inc. V. Adams County Bd. of Equalization*, 261 Neb. 130, 621 N.w.2d 518 (2001).

The possible results from application of the presumption as a standard of review and the statutory standard of review are: (1) the presumption is not overcome and the statutory standard is not overcome; (2) the presumption is overcome and the statutory standard is not overcome; (3) the presumption is not overcome and the statutory standard is overcome; (4) and finally the presumption is overcome and the statutory standard is overcome. The first possibility does not allow a grant of relief, neither standard of review has been met. The second possibility does not therefore allow a grant of relief even though the presumption is overcome because the statutory standard remains. See, *City of York v. York County Bd of Equal.*, 266 Neb. 297, 664 N.W.2d 445 (2003). The third possibility requires analysis. The presumption and the statutory standard of review are different legal standards, and the statutory standard remains after the presumption has

been overcome. See. Id. The burden of proof to overcome the presumption is competent evidence. Id. Clear and convincing evidence is required to show that a county board of equalization's decision was unreasonable or arbitrary. See, e.g. *Omaha Country Club v. Douglas Cty. Bd. of Equal.*, 11 Neb.App. 171, 645 N.W.2d 821 (2002). Competent evidence that the county board of equalization failed to perform its duties or act upon sufficient competent evidence is not always evidence that the county board of equalization acted unreasonably or arbitrarily because the statutory standard of review remains even if the presumption is overcome. *City of York,* supra. Clear and convincing evidence that a county board of equalization's determination, action, order, or decision was unreasonable or arbitrary, as those terms have been defined, may however overcome the presumption that the county board of equalization faithfully discharged its duties and acted on sufficient competent evidence. In any event the statutory standard has been met and relief may be granted. Both standards of review are met in the fourth possibility and relief may be granted.

Use of the presumption as a standard of review has been criticized. See, G. Michael Fenner, About Presumptions in Civil Cases, 17 Creighton L. Rev. 307 (1984). In the view of that author the presumption should be returned to its roots as a burden of proof. Id. Nebraska's Supreme Court acknowledged the difficulty of using two standards of review and classified the presumption in favor of the county board of equalization as a principle of procedure involving the burden of proof, namely, a taxpayer has the burden to prove that action by a board of equalization fixing or determining valuation of real estate for tax purposes is unauthorized by or contrary to constitutional or statutory provisions governing taxation. *See, Gordman Properties Company v. Board of Equalization of Hall County*, 225 Neb. 169, 403 N.W.2d 366 (1987). Use

of the *Gordman* analysis allows consideration of both the presumption and the statutory standard of review without the difficulties inherent in the application of two standards of review. It is within that framework that I have analyzed the evidence.

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Wm R. Wickersham, Commissioner